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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943

No. 445

BONWIT TELLER, INC.,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

ARTHUR B. HYMAN,
Counsel for Petitioner.

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No. 445

BONWIT TELLER, INC.,

against *Petitioner,*

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI.

May It Please the Court:

The petition of Bonwit Teller, Inc., respectfully shows to this Honorable Court:

"A."

Summary Statement of Matter Involved.

The proceedings involve a deficiency in Federal income taxes assessed against the petitioner for the year ending January 31, 1939, amounting to $5,844.63. The deficiency resulted from the disallowance by the Commissioner of Internal Revenue of a deduction from gross income for depreciation of certain permanent building improvements installed at a cost of $618,964.54 by petitioner's predecessor in a tax-free reorganization.

The Tax Court of the United States sustained the Commissioner and was in turn sustained by the United States Circuit Court of Appeals for the Second Circuit.

"B."

Jurisdiction.

1. The statutory provision believed to sustain jurisdiction is Section 240 of the Judicial Code as amended by the Act of February 13, 1925 (Chapter 229, Sec. 1, 43, Stat 938).

2. The decision sought to be reviewed was filed on July 7, 1943; rehearing was denied on July 28, 1943, and the mandate of the Court was entered on the same day.

3. The proceeding in which review is sought was instituted in the Tax Court of the United States. It involves the right of the petitioner, as transferee in a tax-free reorganization, to depreciate permanent improvements installed in leased premises by its predecessor and used therein by it and, after reorganization, by petitioner. The right to the deduction was asserted under the provisions of Sections (23l), (23n), 113 and 114 of the Revenue Act of 1938 (c. 289, 52 Stat. 447). A deficiency order was entered by the Tax Court of the United States and a petition for review was duly filed in the Circuit Court of Appeals for the Second Circuit, which affirmed the determination of the Tax Court.

4. The cases believed to sustain jurisdiction are:

Virginian Hotels Corp. v. *Helvering,* 319 U. S. —;
Detroit Edison Co. v. *Commissioner,* 319 U. S. —;
Duffy v. *Central R. R.,* 268 U. S. 55;
Helvering v. *Lazarus,* 308 U. S. 252;
Nelson v. *Helvering,* 296 U. S. 374.

"C."

Questions Involved.

1. In a tax-free reorganization, predecessor corporation transfers to its successor, in exchange for stock of the latter, all its assets (except leaseholds), including building improvements installed by it and used in its trade and business. The latter, upon its undertaking to pay the rental and other charges reserved in its predecessor's lease and to fully comply with the terms thereof during its occupancy, continues in possession of the premises with the consent of the landlord, pays the rent and other charges and fulfills the covenants of the lease. Without change of management or personnel it continues to carry on the business of its predecessor and continues the use of the demised premises and the building improvements. Does the exclusion from the transfer of its predecessor's lease of the premises preclude the successor corporation from taking a deduction from income of depreciation on such building improvements?

2. Does the execution by lessor and lessee of a new lease modifying the original lease by reducing the term and the rental reserved, extinguish the lessee's right to continue for income tax purposes to take depreciation on building improvements installed by it in the leased premises?

3. Does the subsequent execution of a new lease by the successor corporation with a new owner of the premises, preclude the successor corporation from continuing to take similar depreciation?

4. Does the right to recover a capital investment in building improvements through charges to depreciation, depend upon the existence of a lease?

The material facts, stated as briefly as possible, are as follows:

Petitioner's predecessor, Bonwit Teller & Co., occupied premises 721 Fifth Avenue under a twenty-one year lease, expiring in 1951 (R. 173). Upon taking possession it had installed permanent improvements at a cost of $618,964.54, having an estimated useful life of twenty years, upon which it took annual deductions for depreciation (R. 174). It encountered financial difficulties which made it necessary for the company to obtain two successive reductions in rent (R. 275), the second one resulting in a modification of its lease, evidenced by the execution of a new lease dated December 14, 1932, and, because of the reduced rental, running to September 30, 1938, and containing a ninety-day cancellation clause at the landlord's option (R. 175, 281). Finally it was compelled to go through reorganization. On July 25, 1933, the petitioner was organized and to it were transferred, in exchange for shares of its capital stock, all the assets of its predecessor including "merchandise, furniture, fixtures, improvements and equipment." Excluded from the transfer, however, was the lease of premises 721 Fifth Avenue and leases on certain other premises not involved in this proceeding (R. 176, 282).

The petitioner continued in possession of the leased premises with the consent of the landlord upon its agreement to pay the rent and other charges reserved in its predecessor's lease and to fulfill the covenants thereof so long as it remained in possession. It continued to conduct the business formerly conducted by its predecessor without change of management or personnel and to use in the business the improvements installed by its predecessor (R. 184, 282). In 1933 and 1934 it made additional improvements to the building located on the leased premises at a cost of $3,741.61 (R. 180). On its income tax returns for

the years 1933 to 1936 it claimed depreciation on the building improvements installed by its predecessor and on those installed by it at the rate of 5% per annum. Its returns for those years showed losses for each year and were duly audited by the Commissioner of Internal Revenue and accepted as correct (R. 174).

In April, 1937, the owner of the premises sold the same (R. 183). The agreement preceding the sale stated that it was subject to the original lease of April 7, 1930 and the modified lease of December 14, 1932 entered into by petitioner's predecessor (R. 232, 264), and both the agreement and the instrument of conveyance stated that the premises were sold subject "to the rights of the tenant in possession" (the petitioner) (R. 233, 265). Subsequently, in December of that year, petitioner entered into a new lease with the then owner of the realty for a term extending to January 31, 1950, which took up approximately the balance of the term of the original lease made in 1930 by its predecessor. It is still occupying the premises and using the building improvements in its trade and business (R. 184).

Petitioner's predecessor was adjudicated a bankrupt almost immediately after it transferred its assets to the petitioner in 1933, and on December 5, 1937 it was dissolved by proclamation (R. 180, 190).

It has been stipulated that the foregoing transfer was part of a tax-free reorganization (i. e., one in which neither gain nor loss was realized by either party). It has also been stipulated that if the petitioner is entitled to depreciate the improvements then the basis of such improvements is the adjusted basis in the hands of its predecessor as of the date of the transfer (R. 176, 177).

"D."

Reasons Relied On for the Allowance of the Writ.

1. The absolute statutory right of the petitioner to depreciate the building improvements installed by its predecessor has been denied by the Court below (Sec. 23 (l), 23 (n), 113, 114 I. R. C.). Its decision violates the plain intent of the statutes as well as the principle laid down by this Court in *Helvering* v. *Lazarus* (308 U. S. 252), and *Detroit Edison Company* v. *Commissioner* (319 U. S. —), and more recently repeated in *Virginian Hotels Corp.* v. *Helvering* (319 U. S. —), that a taxpayer's right to recover its investment in a wasting asset flows from *the making of the investment* and the use of the assets in trade and business.

2. The Circuit Court's holding that the acquisition by petitioner of the lease of its predecessor is a prerequisite to the right to depreciate, finds no support in the statutes or in the decided cases and is legally unsound in principle. It is in direct conflict with the decision in *Simon Bricks Co.*, 14 B. T. A. 878, affirmed 45 Fed. (2d) 57, (C. C. A. 9); cert. den. 283 U. S. 834, where improvements made on premises by a tenant at will were held depreciable over the useful life of the improvements; with the case of *George H. Bowman* v. *Commissioner*, 32 Fed. (2d) 404, (Ct. of Appeals, District of Columbia) involving a tenancy from month to month; and with the case of *Elmira Arms*, 7 B. T. A. 703, where depreciation was permitted on a building erected by the taxpayer on premises upon which he had no lease at all. It is also in conflict with *B. Kirk Rankin*, 17 B. T. A. 130; affirmed 60 Fed. (2d) 76, (C. C. A. 6), where the taxpayer was allowed depreciation on improvements installed on property which he had only a contract to purchase.

3. The Circuit Court's holding that petitioner did not acquire its predecessor's estate is contrary to the law of the

State of New York, under which petitioner became the assignee of its predecessor's term, bound over by privity of estate with the landlord to meet the obligations of the lease so long as it remained in possession (*Mann* v. *Munch Brewery*, 225 N. Y. 189; *Frank* v. *N. Y. L. E. & W. R. R. Co.*, 122 N. Y. 197; *Gillette Brothers* v. *Aristocrat Restaurant*, 239 N. Y. 87).

4. The decision below is of far-reaching importance because of its impact upon the depreciation and reorganization provisions of the Internal Revenue Code. Its effect is to frustrate the Congressional will and purpose and to create doubt and uncertainty where neither should prevail. Unless corrected, it will militate against a sound administration of the applicable Code provisions and will give rise to needless controversy and litigation.

WHEREFORE, petitioner respectfully prays that a writ of certiorari issue out of and under the seal of this Honorable Court, directed to the Court of Appeals of the Second Circuit, commanding that Court to certify and send to this Court for its review and determination on a day certain therein to be named, a full and complete transcript of the record and of the proceedings in this case numbered and entitled on its docket No. 18585, Bonwit Teller, Inc. *v.* Commissioner of Internal Revenue, and that said decision of the Circuit Court of Appeals for the Second Circuit may be reviewed by this Honorable Court, and that this petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

BONWIT TELLER, INC.,
By ARTHUR B. HYMAN,
Counsel for Petitioner.